IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 315 of 1984
WITH
INCOME TAX REFERENCE No 377 of 1984

For Approval and Signature:

Hon'ble MR.JUSTICE B.C.PATEL and

MR.JUSTICE M.C.PATEL

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

COMMISSIONER OF INCOME TAX

Versus

AMBICA MILLS LTD

Appearance:

MR RP BHATT for Petitioner

NOTICE SERVED for Respondent No. 1

CORAM : MR.JUSTICE B.C.PATEL and

MR.JUSTICE M.C.PATEL

Date of decision: 12/08/1999

ORAL JUDGEMENT (Per Patel, J.)

The assessee in both these References, Shri Ambica Mills Limited, is a Public Limited Company, which was running five different Divisions.

2. I.T.R. No. 315 of 1984:

This Reference pertains to the Assessment Year 1976-77.

2.1 The Assessee Company had three Managing Directors. Besides the salary, they were given benefits such as commission, house rent, reimbursement of certain expenses, free use of car for personal purpose and reimbursement of telephone expenses installed at their residence. In the course of assessment proceedings, the assessee claimed that the payment of insurance for accident policy, reimbursement of telephone expenses at residence and medical reimbursement expenses were not perquisite for the purpose of Section 40A(5) of the Income Tax Act [hereinafter referred to as the Act].

2.2 The Assessee incurred expenses of Rs.1,08,877/on issue of bonus shares and claimed allowance thereof as revenue deduction. The Income Tax Officer disallowed the same as a capital expenditure on the ground that the issue of Bonus shares can be treated towards the basic structure of the Company and the expenditure involved brought benefit of permanent nature.

2.3 The assessee also claimed deduction of royalty payment of Rs.1,73,229/- to M/s. Mettur Beardsell Limited, Madras which was paid during the accounting period for the use of trade mark "tebilized" and for the other services rendered. The Income Tax Officer was of the view that since Mettur Beardsell was not the owner of the trade mark 'tebilized', the payment of the aforesaid amount to them was for the purpose of the services rendered to the Company. The owner of the trade mark 'tebilized' was M/s. English Sewing Company with whom the assessee had entered into an agreement for the use of the trade mark. The Income Tax Officer, therefore, considered the payment to be an expenditure incurred for the purpose of business of the Company.

2.4 In the aforesaid circumstances, the following three questions are referred to this Court:

"1. Whether, the appellate tribunal has erred in law and on facts of the case in holding that medical expenses and personal accident insurance premium paid by the Company for its Managing Directors were not disallowable under sec. 40A(5) read with sec. 40(c) of the Income-Tax Act, 1961?

2. Whether in the facts and in the circumstances of the case, the appellate Tribunal has not erred in law in holding that the

expenditure of Rs.1,08,877/- incurred by the Company on the issue of bonus shares was not a capital expenditure but of a revenue nature and allowable as such?

3. Whether the amount of Rs.1,73,229/- paid by the assessee to M/s. Mettur Beardsell Ltd., Madras was an allowable deduction on the facts and in the circumstances of the case".

3. I.T. R. No. 377/84.

This Reference pertains to Assessment Years 1977-78 and 1978-79.

3.1 On the same grounds stated hereinabove in paragraph 2.3 above [but with the change of amounts and years], the following question was referred to this Court:

"Whether on the facts and in the circumstances of the case, the assessee was entitled to deduction of Rs.1,79,752/- and Rs.2,01,185/- being the amounts paid to M/s. Mettur Beardsheel Co. Ltd., for the user of its trade mark namely 'tabilized' in the assessment years 1977-78 and 1978 (1978-79 sic) respectively. "

3.2 Similarly, for the same grounds stated in paragraph 2.1 hereinabove, the following question was referred to this Court.

"Whether, on the facts and in the circumstances of the case, reimbursement of medical expenses, personal accident insurance premium and telephone expenses paid to the Directors should be considered while applying the provisions of section 40A(5) of the Income Tax Act, 1961".

4. Thus, question No.1 in ITR No. 312/84 and question No. 2 in ITR No.377/84 are identical. Similarly, question No.3 in ITR No. 312/84 and question No.1 in ITR No. 377/84 are identical.

5. QUESTION NO.1 IN ITR NO. 312/84 AND QUESTION NO. 2 IN ITR NO.377/84.

5.1 So far as question No. 1 is concerned, it requires no detailed discussion as in the case of this very assessee itself, for the A.Y. 80-81 reported in 231 ITR 583, this Court, after considering the provisions held as under:-

"That it was clear from the approval that was sought under section 310 of the Companies Act from the Government that the expenditure in question related to the managing director in his capacity as a director and not an employee of the company. Thus, the expenditure was required to be computed under section 40 (c)(i) of the Act. The said clause takes within its sweep any expenditure on remuneration or benefit or amenity to a director and the word "remuneration" would, therefore, obviously include direct cash payments to the director. Therefore, expenditure incurred on cash reimbursement of medical expenses to the managing director would fall within sub-clause (i) of clause (c) of section 40 and not under section 40A(5)(a) under which only expenditure incurred on a person in his capacity of an employee could be computed where such employee is also a director."

5.2 Similar questions are raised in the aforesaid References. In view of the aforesaid view expressed by the Court earlier, the answer must be in positive and in favour of the Revenue so far question No.1 in ITR No. 312/84 and question No. 2 in ITR No.377/84 are concerned.

6. QUESTION NO. 2 IN ITR NO. 312/84.

6.1 So far as question No. 2 in ITR No. 312/84 is concerned, on an identical question in the case of CIT vs. AJIT MILLS LTD reported in 210 ITR 658, this Court held that that such expenditure is not deductible as revenue expenditure and that the expenses incurred in connection with the issuance of bonus shares are incurred by the Company for its permanent structure and are directly connected with the acquisition of capital and with the advantage of enduring nature. While deciding this question in the case of Ajit Mills (supra) this Court has also relied on the decisions in the case of SHREE DIGVIJAY CEMENT CO. LTD. VS. CIT [1982] 138 ITR 45 and AHMEDABAD MFG. & CALICO PVT. LTD. VS. CIT [1986] 162 ITR 800.

6.2 In view of the aforesaid decisions, this question must be answered in negative and in favour of the Revenue.

7. QUESTION NO.3 IN ITR NO. 312/84 AND QUESTION NO.1 IN ITR NO. 377/84

7.1 With regard to these questions, Mr. Bhatt, learned advocate fairly stated that the same is answered by a decision of this Court in the case of C.I.T. vs. ASHOKA MILLS LTD reported in 218 ITR 526. In that case also, an agreement was entered into for the use of trade mark 'tebilized', and on Reference, this Court held that the assessee was carrying on business of manufacturing cloth; The process employed under the trade name 'Tebilized' conferred anti-crease property on the cloth; The assessee entered into the above agreement for the purpose of enabling the assessee to carry on its business more efficiently and more profitably, while leaving the fixed capital untouched; The agreement is permitting the assessee to make use of the particular process and the user of the trade mark 'Tebilized' did not create any asset nor did they confer any right of a permanent nature in favour of the assessee. The Court further held that apart from the fact that the agreements in the present case do not confer any right for exclusive user, the duration of the agreement is for only eight years, that too terminable by six months' prior notice; The agreements merely enable the assessee to confer on the

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antages of better quality and marketability. The payment of royalty in that case was, therefore, held to be clearly in the course of profit-earning process and not for acquisition of an asset or right of a permanent character.

7.2 In the light of the aforesaid, question No.3 in ITR No. 312/84 and question No.1 in ITR No. 377/84 must he answered in positive in favour of the assessee, and against the revenue.

8. Both these References stand disposed of accordingly, with no orders as to costs.

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